

March 19, 1998

Barbara A. Schermerhorn
Clerk

NOT FOR PUBLICATION

**UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE TENTH CIRCUIT**

IN RE ROBERT BERNARD
TAYLOR, also known as Robert B.J.
Taylor, and DEBRA GAIL TAYLOR,

Debtors.

BAP No. KS-97-064

J. MICHAEL MORRIS, Trustee,
Plaintiff - Appellee,

v.

FIRST NATIONAL BANK AND
TRUST OF PHILLIPSBURG,

Defendant - Appellant,

ROBERT BERNARD TAYLOR and
DEBRA GAIL TAYLOR,

Defendants.

Bankr. No. 96-11295
Adv. No. 96-5200
Chapter 7

ORDER AND JUDGMENT*

Appeal from the United States Bankruptcy Court
for the District of Kansas

Before McFEELEY, Chief Judge, CLARK, and MATHESON, Bankruptcy Judges.

CLARK, Bankruptcy Judge.

First National Bank and Trust of Phillipsburg ("Bank") has appealed a
Judgment of the United States Bankruptcy Court for the District of Kansas

* This order and judgment has no precedential value and may not be cited,
except for the purposes of establishing the doctrines of law of the case, res
judicata, or collateral estoppel. 10th Cir. BAP L.R. 8010-2.

allowing the chapter 7 trustee (“Trustee”) to avoid the Bank’s unperfected security interest in an automobile pursuant to 11 U.S.C. § 544(a)(1), and collect for the benefit of the estate pursuant to 11 U.S.C. § 551 money due from the Debtors under a promissory note executed in favor of the Bank. For the reasons stated below, the bankruptcy court is AFFIRMED to the extent that it concluded that the Bank’s security interest in the automobile is avoidable under section 544(a)(1). We will not address issues raised by the Bank related to the propriety of the bankruptcy court’s decision under section 551, as the Bank lacks standing to appeal.

I. Background

In February 1996, the Debtors executed a promissory note and security interest in favor of the Bank. The security interest was in a Chevrolet van and other vehicles. In March 1996, the other vehicles subject to the security interest were released, a Pontiac was substituted as collateral, and the Bank’s security interest in the Chevrolet van was perfected. On April 23, 1996, the Debtors filed for relief under chapter 7 of the Bankruptcy Code. The Bank’s interest in the Pontiac was not perfected on the petition date. The Debtors claimed the Pontiac as exempt, and no objection to their claimed exemption was made.

The Trustee filed a complaint against the Bank and the Debtors to avoid the Bank’s interest in the Pontiac and the Chevrolet. The Trustee alleged that the Bank’s interest in the Pontiac was avoidable under section 544(a), and that upon avoidance the Trustee was entitled to preserve the interest for the benefit of the estate under section 551 (“Strong Arm Action”). The Trustee also alleged that the Bank’s interest in the Chevrolet was avoidable under section 547(b), and that upon avoidance he could recover the transfer from the Bank under section 550 and preserve the interest for the benefit of the estate under section 551 (“Preference Action”). Appellant’s Appendix, p. 1, Complaint.

The Debtors did not answer the Trustee’s complaint. Accordingly, in

October 1996, the bankruptcy court entered an Order Granting Default Judgment (“Default Judgment”) against the Debtors that stated, in relevant part, that: “[t]o the extent the Trustee avoids the Bank’s lien, the same will be preserved for the benefit of the estate. The lien will be the extent of the Bank’s claim as of the date of filing.” Appellee’s Appendix, Default Judgment, p. 1. The Debtors were directed to make all payments on the lien to the Trustee pending the outcome of the adversary action against the Bank. Id.

The Trustee and the Bank submitted briefs to the bankruptcy court based upon stipulated facts. The parties apparently agreed to abandon or settle the Preference Action involving the Chevrolet van, as the bankruptcy court was only asked to rule on the Strong Arm Action involving the Pontiac. The bankruptcy court subsequently entered an Order Granting Trustee’s Complaint to Avoid Bank’s Unperfected Security Interest (“Order”) and a Judgment on the Order. The Bank appealed the bankruptcy court’s Order and Judgment to this Court.

II. Discussion

The bankruptcy court held that the Bank’s interest in the Debtors’ Pontiac was avoidable under section 544(a)(1) because it was unperfected on the date that the Debtors filed their chapter 7 petition, and that the Trustee was entitled to preserve the lien for the benefit of the estate under section 551. The Bank does not contest that its interest in the Pontiac was unperfected on the date that the Debtors filed their chapter 7 petition, *see* Appellant’s Brief, p. 2, but rather maintains that the bankruptcy court erred in finding that its interest was avoidable under section 544(a)(1) because the Debtors claimed the Pontiac as exempt and, therefore, the interest in the vehicle transferred to the Bank was not property of the estate. Even if the interest is avoidable under section 544(a)(1), the Bank maintains that the bankruptcy court misconstrued the effect of that avoidance under section 551. Each argument is addressed below.

1. The bankruptcy court did not err in finding that the Bank's interest in the Pontiac was avoidable under section 544(a)(1).

The bankruptcy court held that the Bank's unperfected security interest in the Pontiac was avoidable under section 544(a)(1). In so holding, the bankruptcy court rejected the Bank's argument that its interest was not avoidable because the Debtors claimed Pontiac as exempt and, therefore, it was not property of the estate. The bankruptcy court stated that section 544(a)(1) was not limited to transfers of interests in property of the estate, but rather applied to any transfer of "property of the debtor," including property claimed as exempt, such as the Pontiac. Appellant's Appendix, Order, pp. 5-6.

The bankruptcy court's analysis of this issue is flawed. Under Begier v. IRS, 496 U.S. 53, 58-59 (1990), we have been directed to look to the definition of "property of the estate" for guidance in interpreting the phrase "property of the debtor" used in the avoidance sections of the Bankruptcy Code. Nevertheless, the bankruptcy court's conclusion that the Bank's interest in the Pontiac is avoidable under section 544(a)(1) is correct for two reasons.

First, it is well established that exemptions are personal to the debtor and may not be asserted by a creditor as a defense to an avoidance action. *See, e.g., Fox v. Smoker (In re Noblit)*, 72 F.3d 757, 758 & n.1 (9th Cir. 1995) (citing cases); Waldschmidt v. Sanders (In re Sanders), 213 B.R. 324, 329-30 (Bankr. M.D. Tenn. 1997).² Accordingly, the Bank may not assert the Debtors' exemption as a defense to the Trustee's Strong Arm Action. Since the Bank does not contest that its interest in the Pontiac was unperfected on the date that the Debtors filed their chapter 7 petition, the bankruptcy court did not err in concluding that such interest was avoidable under section 544(a)(1).

² In Rutledge v. Johansen, 270 F.2d 881, 882 (10th Cir. 1959), the court held under the Bankruptcy Act that exempt property may not be subject to avoidance under preference law. As pointed out in Noblit, however, the law has changed under the Bankruptcy Code in that exempt property is no longer excluded from the bankruptcy estate as it was under the Bankruptcy Act. 72 F.3d at 758-59; *see* discussion *infra*. Accordingly, Rutledge no longer has any effect.

Second, even if the Bank could claim the Debtors' exemptions as a defense, its defense would fail. Property claimed as exempt is property of the estate on the petition date, and a trustee's ability to avoid a transfer is judged as of the petition date. *See Taylor v. Freeland & Kronz*, 503 U.S. 638, 642 (1992); *Owen v. Owen*, 500 U.S. 305 (1991). Indeed, there is nothing in section 541(b) excluding exempt property as property of the estate, and section 522(b) specifically states that "[n]otwithstanding section 541 . . . , an individual debtor may exempt from property of the estate" the property designated within that section. 11 U.S.C. § 522(b); *Owen*, 500 U.S. at 309-09. Accordingly, the fact that the Debtors claimed the Pontiac as exempt did not affect the Trustee's right to avoid the Bank's lien under section 544(a).

2. The Bank does not have standing to appeal that portion of the bankruptcy court's Order regarding the affect of the avoidance of its lien under section 551.

Finding that the Bank's interest in the Pontiac was avoidable under section 544(a)(1), the bankruptcy court went on to hold that section 551 "allows the trustee to foreclose an avoided security interest against the debtors and to keep junior lienholders in the same property from improving their position upon avoidance of the senior lien." Appellee's Appendix, Order, p. 5. As such, the bankruptcy court found that the trustee could "collect the debtor's payments for the estate" regardless of the Debtors' claimed exemption in the Pontiac. *Id.*

The Bank contends that the bankruptcy court erred in authorizing the Trustee to collect the remaining payments due under the promissory note executed by the Debtors under section 551 as the Debtors have claimed the Pontiac as exempt. The Bank essentially is upset that the Debtors are required to pay the estate as a result of the avoidance of its lien. When viewed in this light, it is clear that the Bank does not have a "direct stake in the outcome" of this appeal. *Arizonans for Official English v. Arizona*, 117 S. Ct. 1055, 1067 (1997) (quoting *Sierra Club v. Morton*, 405 U.S. 727, 740 (1972)). The real parties in

interest are the Debtors, who have been ordered by the bankruptcy court to make payments to the estate under both the Default Judgment and the Order that is the subject of this appeal. The Debtors, however, are not parties to this appeal. Since the Bank does not have standing, we will not address whether the bankruptcy court's decision under section 551 was correct.

III. Conclusion

Accordingly, for the reasons stated above the bankruptcy court is AFFIRMED to the extent that it has held that the Bank's security interest in the Pontiac is avoidable under section 544(a)(1). We will not consider that portion of the bankruptcy court's Order and Judgment related to section 551, as the Bank does not have standing to appeal.